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MISSOURI LOTTERY

FINANCIAL STATEMENTS AS OF
JUNE 30, 1990 AND 1989
TOGETHER WITH AUDITORS' REPORT

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ARTHUR ANDERSEN & CO.

St. Louis, Missouri

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Missouri Lottery Commission:

We have audited the accompanying balance sheets of the Missouri Lottery June 30, 1990 and 1989, and the related statements of revenues, expenditures and retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Lottery as of June 30, 1990 and 1989, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen & Co.

St. Louis, Missouri,
October 24, 1990

MISSOURI LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1990 AND 1989

	<u>1990</u>	<u>1989</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash	\$18,578,131	\$19,270,411
Accounts receivable, net	2,037,543	2,294,540
Current portion of investments	967,333	-
Accrued interest and other receivables	13,150	25,452
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Total current assets	21,596,157	21,590,403
INVESTMENTS, less current portion	8,497,374	-
PROPERTY AND EQUIPMENT, net	4,106,805	5,095,551
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Total assets	\$34,200,336	\$26,685,954
	=====	=====
<u>LIABILITIES AND RETAINED EARNINGS</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 2,020,039	\$ 2,190,547
Accrued prize liabilities	6,565,375	4,271,109
Due to General Revenue Fund	6,238,649	10,468,387
Other accrued liabilities	670,715	436,409
Current portion of deferred grand prize annuities payable	967,333	-
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Total current liabilities	16,462,111	17,366,452
DEFERRED GRAND PRIZE ANNUITIES PAYABLE, less current portion	8,497,374	-
OTHER DEFERRED LIABILITIES	645,372	724,023
RETAINED EARNINGS	8,595,479	8,595,479
	-----	-----
Total liabilities and retained earnings	\$34,200,336	\$26,685,954
	=====	=====

The accompanying notes are an integral part of these balance sheets.

MISSOURI LOTTERY

STATEMENTS OF REVENUES, EXPENDITURES AND RETAINED EARNINGS

FOR THE YEARS ENDED JUNE 30, 1990 AND 1989

	<u>1990</u>	<u>1989</u>
OPERATING REVENUES:		
Instant ticket sales	\$114,533,882	\$109,754,365
On-line ticket sales	107,053,182	89,448,017
Pull-tab ticket sales	1,780,083	-
Total operating revenues	<u>223,367,147</u>	<u>199,202,382</u>
OPERATING EXPENDITURES:		
Instant prize expense	62,590,775	55,993,573
On-line prize expense	53,526,591	44,155,871
Pull-tab prize expense	1,157,054	-
Instant retailer commissions and incentives	6,524,041	6,077,857
On-line retailer commissions and incentives	6,091,749	5,305,969
Pull-tab retailer commissions and incentives	152,280	-
Cost of tickets sold	6,153,692	4,526,032
Wages and benefits	5,362,531	4,887,344
Advertising and promotions	7,735,377	8,079,988
Other general and administrative	5,334,401	5,043,296
Total operating expenditures	<u>154,628,491</u>	<u>134,069,930</u>
Operating revenues over expenditures	<u>68,738,656</u>	<u>65,132,452</u>
NONOPERATING REVENUES:		
Interest income	1,800,020	1,684,650
Other	152,934	240,335
Total nonoperating revenues	<u>1,952,954</u>	<u>1,924,985</u>
Income before operating transfers	<u>70,691,610</u>	<u>67,057,437</u>
OPERATING TRANSFERS TO GENERAL REVENUE FUND	(70,691,610)	(68,898,463)
ADDITIONAL LEGISLATIVE TRANSFERS	-	(28,000,000)
Excess of expenditures and transfers over revenues	<u>-</u>	<u>(29,841,026)</u>
RETAINED EARNINGS AT BEGINNING OF YEAR	8,595,479	38,436,505
RETAINED EARNINGS AT END OF YEAR	<u>\$ 8,595,479</u>	<u>\$ 8,595,479</u>

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1990 AND 1989

	<u>1990</u>	<u>1989</u>
CASH FLOWS PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Excess of expenditures and transfers over revenues	\$ -	\$(29,841,026)
Adjustments to reconcile the excess of expenditures and transfers over revenues to net cash used for operating activities-		
Depreciation	1,148,076	1,105,429
Change in assets and liabilities-		
Decrease (increase) in accounts receivable, net	256,997	(888,433)
Decrease in accrued interest and other receivables	12,302	231,957
Decrease in instant lottery ticket inventories	-	544,279
Increase in accounts payable and other accrued liabilities	63,798	545,100
Increase in accrued prize liability	2,294,266	215,238
Increase in deferred grand prize annuities payable	9,464,707	-
(Decrease) increase in due to General Revenue Fund	(4,229,738)	3,072,134
(Decrease) increase in deferred liabilities	(78,651)	724,023
Net cash provided by (used for) operating activities	<u>8,931,757</u>	<u>(24,291,299)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of zero coupon bonds	(9,464,707)	-
Additions to property and equipment, net of retirements	(159,330)	(750,528)
Net cash used for investment activities	<u>(9,624,037)</u>	<u>(750,528)</u>
NET DECREASE IN CASH	<u>(692,280)</u>	<u>(25,041,827)</u>
CASH, beginning of year	19,270,411	44,312,238
CASH, end of year	<u>\$18,578,131</u>	<u>\$ 19,270,411</u>

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1990 AND 1989

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri Lottery (the Lottery) is accounted for as a proprietary type enterprise fund and is a component unit of the State of Missouri. The financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting and conform with practices generally followed in the gaming industry.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances have been established for estimated tickets to be returned by retailers of \$571,000 and \$421,000 at June 30, 1990 and 1989, respectively.

Sales of pull-tab tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player.

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Lotto America" and the daily "PICK 3" games. Sales of lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Investments and Deferred Grand Prize Annuities Payable

Prior to March 1990, the Lottery purchased annuity contracts from selected insurance companies to fund "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying balance sheets.

In March 1990, to fund future payments under subsequent prize claims, the Lottery began purchasing U.S. Treasury zero coupon bonds with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in safekeeping by the Federal Reserve Bank. The investments in these securities are carried at cost, adjusted for the accretion of discounts based on the purchase yield and the maturity date. Discount accreted on these investments is not recognized as revenue of the Lottery but is credited to deferred grand prize annuities payable. These securities are not subject to trading and are intended to be held to maturity.

Prizes

Expenditures for instant lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Expenditures for on-line lottery ticket prizes are recorded based on 50% of on-line lottery ticket sales. Prior to the passage of an amendment to statutory requirements (see Note 2) that became effective in September 1988, prizes were recorded based on a 45% statutory requirement as the maximum prize percentage.

The minimum grand prize amount for the semiweekly "LOTTO" game is \$1,000,000. Any prize that remains unclaimed for one year from the date of the on-line game drawing is used to fund future prize pools.

Retailer Fees

Licensed retailers are charged an annual fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectible accounts receivable from retailers. This reserve fund approximated \$363,000 and \$319,000 at June 30, 1990 and 1989, respectively, and is reflected as a reduction of accounts receivable on the accompanying balance sheets.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated life of the related asset. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

Due to General Revenue Fund

Under current statutes, all income before operating transfers of the Lottery, as described in the accompanying income statement, accrues to the benefit of the General Revenue Fund. Prior to September 1988, the liability to the General Revenue Fund was computed as 45% of sales. Operating transfers to the General Revenue Fund are made monthly and are based on estimated income before operating transfers. A portion of the liability to the General Revenue Fund equal to the net book value of capital additions after September 1, 1988, is not subject to current operating transfers.

2. STATUTORY REQUIREMENTS:

The constitutional amendment and law provides that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Legal and investigative services are provided by the Attorney General's office and the Missouri State Highway Patrol, respectively. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

	<u>1990</u>	<u>1989</u>
LOTTO	\$ 49,079,208	\$50,236,771
Lotto America (Missouri Megabucks)	38,007,956	22,816,977
PICK 3	19,966,018	16,394,269
	<u>\$107,053,182</u>	<u>\$89,448,017</u>
	=====	=====

4. CASH:

Cash consists of funds on deposit with the State Treasurer and banks. The cash on deposit with the State Treasurer is pooled with other Missouri State funds and is fully secured by the depository institutions holding the funds.

5. INVESTMENTS:

Investments as of June 30, 1990, are as follows:

Cost at date of purchase	\$9,268,085
Plus- Accreted discount	196,622
	<u>9,464,707</u>
Less- Current portion	(967,333)
Long-term investments	<u>\$8,497,374</u>
	=====

The market value of these investments at June 30, 1990, was \$9,473,000. The maturity value of securities held at June 30, 1990, was \$19,418,000.

6. PROPERTY AND EQUIPMENT:

Property and equipment, net consists of the following:

	<u>1990</u>	<u>1989</u>
Land	\$ 184,512	\$ 184,512
Building	2,505,721	2,505,721
Computers and related software	2,090,472	2,013,402
Autos	999,120	1,337,736
Equipment	2,361,353	2,345,228
	<u>8,141,178</u>	<u>8,386,599</u>
Less- Accumulated depreciation	4,034,373	3,291,048
	<u>\$4,106,805</u>	<u>\$5,095,551</u>
	=====	=====

7. PENSION PLAN:

The Lottery participates with other state agencies in the Missouri State Employees Retirement Plan. The plan is a multiagency defined benefit plan that covers substantially all employees. The Lottery's contributions to the plan in fiscal 1990 and 1989 were \$416,434 and \$372,282, respectively.

8. LEASES:

The Lottery's regional facilities are held under lease agreements that originally expired June 30, 1989, and have been renewed under options available for three to five additional one-year periods. Annual rent expense for these facilities totaled \$143,520 and \$141,444 in fiscal 1990 and 1989, respectively.